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DEPARTMENT FOR MILLENIUM CHALLENGE CORPORATION

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SUBJECT: Nicaragua's Economic Decline Continues

REF: A) MANAGUA 1009; B) MANAGUA 1034; C) MANAGUA 947

Summary

¶1. (SBU) While forecasts of Nicaragua's 2009 economic growth rate differ slightly, they all point to a gloomy horizon, despite signs that the

Negative Forecasts

¶2. (U) The Nicaraguan economy faces a challenging future. A prominent local think tank, the Nicaraguan Foundation for Economic and Social Development (FUNIDES), forecasts a GDP decrease of 2 to 3.5% for 2009 and a decrease of 1 to 2% for 2010. Alejandro Arauz, a respected independent economist, estimates that Nicaraguan GDP will fall from 2.2 to 3.3% this year, while The Economist's Economic Intelligence Unit (EIU), in its September 2009 report, forecasted a GDP decrease of 3.1%. Meanwhile, the Nicaraguan Central Bank (BCN) recently reported a 2.1% decrease in the country's GDP during the first six months of 2009.

¶3. (U) According to the BCN's Index of Monthly Economic Indicators (IMAE), hard-hit sectors included manufacturing (especially apparel and automobile-part assembly as well as food processing), retail, hotels and restaurants, transportation, telecommunications, financial services and, above all, construction. The IMAE reported a decrease in construction activity of 18% from January to August of 2009. The sector has been impacted by a decrease in capital spending and a lack of credit for private investment.

¶4. (U) Agricultural production fared better. Planted areas for rice, sorghum, corn and beans increased during Nicaragua's first harvest when compared to 2008. The BCN's IMAE reported 3% growth for the sector from January to August of 2009, a substantial improvement when compared to 3.9% contraction during the same period in 2008. Unfortunately, due to the lack of rainfall caused by the "El Ni????o" climatic phenomenon, the second harvest is expected to be very meager (Ref A).

¶5. (U) Meanwhile, according to recent data from the International Monetary Fund, the GON pursued an expansionary fiscal policy (higher salaries and pensions) during the first half of 2009, resulting in a 5% increase in the IMAE for central government spending so far in 2009.

Labor and Unemployment

¶6. (U) Measuring the unemployment rate in Nicaragua is difficult, as official GON statistics are unreliable. However, data from the Nicaraguan Institute of Social Security (INSS) report the number of registered employees, which approximates the number of people working in the formal sector. During the first six months of 2009, registered INSS employees increased by only 1.3%, compared to an increase of 9% over the same period in 2008. As of August 2009, there were 506,073 people registered in the INSS system. According to INSS data, employment expanded in agriculture, transportation and utilities, while it contracted in the manufacturing and construction sectors. The BCN reports that the unemployment rate in Nicaragua is between 4 and 5%. However, as 65% of the labor force works in the informal sector, most economists believe that the true unemployment figure is much higher, and underemployment higher still.

Foreign Investment Down for the First Time in 6 Years

¶7. (U) According to ProNicaragua, the GON's investment promotion agency, in 2008 foreign direct investment (FDI) totaled $626 million, equivalent to 9.9% of GDP and a 64% increase over 2007. However, during the first six months of 2009, FDI decreased by 9% compared to the same period in 2008. Overall investment was $231 million for the first half of 2009, and investment in free trade zones (FTZs) diminished significantly, down from $89 million in 2008 to $50 million in 2009, a 44% decrease. According to ProNicaragua, this negative trend is likely to continue in the near term.

Decreases in Imports, Exports and Remittances

¶8. (U) Nicaraguan exports, especially to the United States, had steadily increased since the late 1990s. Coffee, apparel, cattle,

dairy products, gold, and peanuts are the most important exports. In 2008, however, Nicaragua -- like many countries in Central America -- felt the effects of the global economic crisis. BCN data show that exports fell by 12% during the first six months of 2009 compared to the same period in 2008, falling from $831 million to $726 million. Imports also decreased during the same period, falling by 21%, from $2.1 billion to $1.6 billion. Since imports decreased at a greater rate than exports, Nicaragua's trade deficit fell, dropping from $1.2 billion to $863 million. Nicaragua's trade deficit is equivalent to approximately 13.6% of the country's GDP. FTZ exports (mostly textiles and apparel, but also automobile parts and cigars) were also affected. During the first six months of 2009 they fell by 19% compared to the same period the previous year. Remittances also fell, falling from $408 million during the first six months of 2008 to $390 in the first six months of 2009, a 4% decrease. International reserves, however, have remained stable, increasing by 22% since December of 2008 to $1.3 billion as of September of 2009.

Inflation Down Dramatically

¶9. (U) Inflation has declined dramatically so far during 2009. Accumulated inflation in September 2009 was 0.19%, down from 13.97% in Septembe

Consumer and Business Confidence Low

¶10. (U) A consumer confidence survey performed by FUNIDES in June of 2009 revealed that 56% of households have experienced a decrease in their

¶11. (U) Business confidence was also measured by the survey. Most Nicaraguan companies interviewed reported a decrease in sales, and 75% thought that the economic situation was worse than in 2008. Likewise, 71% of companies interviewed reported that the current business climate is worse than in 2008, and 88% said that the investment climate in Nicaragua is unfavorable. In terms of labor, 76% of surveyed companies said they will maintain their current levels of employment. Businessmen surveyed reported that corruption, the political environment, tight credit, the price of energy, and the cost of raw materials are the most detrimental factors affecting their operations.

Comment

¶12. (SBU) Nicaragua began to suffer the effects of the global financial crisis at about the same time as many other Latin American economies, in late 2008. However, the effects here are compounded by internal political factors that make it likely Nicaragua will not see much in the way of economic growth until
¶2011. President Ortega's initial reaction to the crisis was to introduce a government austerity program, with measures such as a shortened workday for GON employees. With customs and other agencies now working half-days, the result has been to make government services, on which the private sector depends, even less efficient. The GON has cut its budget three times in 2009, each time cutting infrastructure and social spending, while maintaining -- and even increasing -- bloated civil service payrolls. All the while, the investment climate continues to deteriorate, as evidenced by the decline in FTZ investment and a lack of due process and transparency that has in turn made infrastructure investment risky (Refs B and C). So, rather than take steps to improve Nicaragua's competitiveness in the face of economic crisis, it looks to us like President Ortega is undermining it.
SANDERS